



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

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Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

L =  
M =  
N =  
O =  
P =  
Q =

Dear \_\_\_\_\_ :

We have considered your ruling request dated October 5, 2004, in which certain rulings were requested regarding the federal tax consequences associated with the proposed transfer of assets from L to M.

L is a nonprofit public benefit corporation created under the laws of the State of N. L is recognized as exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code (the Code) and is classified as a private foundation under section 509(a). The principal place of administration of L is the State of N. O and his wife P have been the only substantial contributors to L since its inception.

O and P also established M as a charitable trust under the laws of the State of N. M is recognized as exempt from federal income tax under section 501(c)(3) of the Code and is classified as a private foundation under section 509(a). The principal place of administration of M is the State of N. O and P have been the only substantial contributors to M other than a governmental agency.

O, P, and Q, are the directors of L and O and P are the sole trustees of M. L proposes to transfer all of its assets to M, which is essentially controlled by the same persons who control L. M intends to use the assets transferred by L exclusively to support the exempt purposes of both L and M. It has been represented in subsequent materials provided that all legal, accounting and other expenses, if any, incurred to implement the transfer of L's assets to M are reasonable and necessary expenses under N State law.

It is believed that the distribution of all of the assets of L to M is in the best interest of both L and M for the following reasons:

a. The trust format of M will allow for a reduction in administration expenses and for more effective management and ultimate disposition of the assets than the corporate structure used for L.

b. The trust format of M allows for more flexibility in the appointment of successor trustees than L which is currently bound by the restrictions imposed by the N Nonprofit Corporation Law.

It has been represented that upon receipt of a favorable ruling from the Service, L proposes to transfer, for no consideration, all of its assets to M and then L will dissolve pursuant to L's Articles of Incorporation and Bylaws and the laws of the State of N.

L has not notified the Service that it intends to terminate its private foundation status, nor has L ever received a notification that its status as a private foundation has been terminated. It has been further represented that L has not committed willful repeated acts or failures to act or a willful and flagrant act or failure to act giving rise to a termination pursuant to section 507(a)(2) of the Code.

Based on the above, the following rulings have been requested:

1. The transfer of the assets of L to M will not affect the status of L as an organization described in section 501(c)(3) of the Code;
2. The transfer of the assets of L to M will constitute a transfer described in section 507(b)(2) of the Code and will not constitute a termination of L's private foundation status giving rise to imposition of the termination tax under section 507(c) of the Code;
3. The transfer of the assets of L to M will constitute a transfer described in section 507(b)(2) of the Code, and accordingly, M shall not be treated as a newly created organization;
4. After the transfer of the assets of L to M, the experiences of both Foundations shall be aggregated for purposes of determining whether M qualifies under section 4940(e) of the Code for reduced excise tax on net investment income
5. The transfer of assets by L to M will not constitute an act of self-dealing within the meaning of section 4941 of the Code with respect to M, any foundation manager,,,, or other disqualified persons;
6. L's transfer of all of its assets to M may be counted toward satisfaction of L's charitable distribution requirements under section 4942 of the Code if, and to the extent, that section 4942(g) of the Code is met by M in that specific regard;

7. The transfer of the assets of L to M will not constitute a taxable expenditure within the meaning of section 4945 of the Code;
8. L will not be required to exercise expenditure responsibility under sections 4945(d)(4) and (h) of the Code with respect to the proposed transfer; and
9. The legal, accounting and other expenses incurred to implement the transfer of L's assets to M are reasonable and necessary expenses paid to accomplish a purpose described in section 170(c)(1) or section 170(c)(2)(B) of the Code, and that therefore, (a) pursuant to section 53.4942(a)-3(a)(2)(i) of the Income Tax Regulations, the expenses will constitute "qualifying distributions" under section 4942 of the Code, and (b) if paid in the good faith belief that they are reasonable and consistent with ordinary business care and prudence, the expenses will not themselves be taxable expenditures, pursuant to section 53.4945-6(b)(2) of the Regulations.

Section 507(a)(1) of the Code provides that the status of a private foundation shall be terminated if the organization notifies the Secretary or his delegate in a manner prescribed in the Income Tax Regulations (the Regulations) of its intent to accomplish such termination and the organization pays the tax imposed by Section 507(c) or the tax is abated under section 507(g) of the Code.

Section 1.507-3(a)(9) of the Regulations provides that if the transferor foundation transfers all of its assets to a transferee foundation which is controlled, directly or indirectly, by the same person or persons which effectively controlled the transferor foundation, for purposes of chapter 42 (section 4940 et seq.) and part II of subchapter F of chapter 1 of the Code (section 507 through 509), such transferee foundation shall be treated as if it were the transferor (except that the transferor foundation is required to file all tax returns and to comply with all other publicity requirements set forth in the Code with respect to private foundations and to file the required return with respect to its liquidation, dissolution or termination).

Section 507(b)(2) of the Code provides that in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee foundation shall not be treated as a newly created organization.

Section 507(c) of the Code imposes on each organization described in section 507(a) a tax equal to the lowest of (1) the amount which the private foundation substantiates by adequate records or other corroborating evidence as the aggregate tax benefit resulting from the section 501(c)(3) status of such foundation, and (2) the value of the net assets of such foundation.

Section 1.507-3(c)(1) of the Regulations provides that for purposes of section 507(b)(2), the terms "other adjustment, organization or reorganization," shall include a significant disposition of assets. Section 1.507-3(c)(2) of the Regulations provides that the term "significant disposition of assets" includes any disposition by a foundation in a taxable year to one or more other private foundations which is 25 percent or more of the fair market value of the net assets of the distributing foundation at the beginning of the taxable year.

Section 1.507-3(d) of the Regulations provides that if a private foundation transfers all or part of its assets to one or more other private foundations pursuant to a transfer described in section 507(b)(2) of the Code, such transferor foundation will not have terminated its private foundation status under section 507(a)(1) of the Code.

Section 4940 of the Code imposes upon each private foundation exempt from taxation under section 501(a) for the taxable year, a tax equal to two percent of the net investment income of such foundation for the taxable year.

Section 4940(e) of the Code provides for a reduction in the excise tax on net investment income to one percent where a private foundation meets certain distribution requirements. Section 4940(e)(6) provides that in the case of a private foundation which is a successor to another private foundation (e.g., by merger), the determination of whether the successor foundation qualifies for the reduced excise tax shall be made by taking into account the experience of the transferor foundation and the successor foundation.

Section 4941 of the Code imposes tax upon any act of self-dealing between a private foundation and any of its disqualified persons as defined in section 4946 of the Code. However, section 53.4946-1(a)(8) of the Regulations provides that, for purposes of self-dealing under section 4941 of the Code, an exempt organization under section 501(c)(3) of the Code is not a disqualified person.

Section 4942 of the Code requires that a private foundation must expend qualifying distributions under section 4942(g) of the Code for the conduct of exempt purposes, with special requirements for private operating foundations.

To meet the requirements of section 4942(g) of the Code, the transferor foundation must have adequate records to show that the transferee foundation makes qualifying distributions that are equal to the amount that the transferor foundation is required to make for the year of the transfer. Such qualifying distribution must be paid out of the transferee's own corpus within the meaning of section 4942(h), before the close of the transferee's first taxable year after the transferee's taxable year in which the section 507(b)(2) transfer was received.

Section 53.4942(a)-(3)(a)(2)(i) of the Regulations defines the term qualifying distribution as any amount (including program-related investments, as defined in section 4944(c), and reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(1) or (2)(B).

Section 53.4945-6(b)(2) of the Regulations provides that any expenditures for unreasonable administrative expenses, including compensation, consultant fees, and other fees for services rendered, will ordinarily be taxable expenditures under section 4945(d)(5) unless the foundation can demonstrate that such expenses were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrence of such expenses in such amounts was consistent with ordinary business care and prudence. The determination whether an expenditure is unreasonable shall depend upon the facts and circumstances of the particular case.

Section 53.4945-6(c)(3) of the Regulations provides that a transfer of assets of a private foundation under section 507(b)(2) of the Code is not a taxable expenditure if such transfer is to an organization described in section 501(c)(3) of the Code.

Section 1.507-3(a)(7) of the Regulations provides that a private foundation that has disposed of all of its assets need not comply with the "expenditure responsibility" rules of sections 4945(d)(4) and (h) of the Code while it has no assets.

Rev. Rul. 2002-28, 2002-1 C.B. 941, discusses, among other things, a private foundation's responsibilities when it transfers all of its assets to one or more effectively controlled private foundations. The law and analysis of Rev. Rul. 2002-28 (in situation 2 specifically) is applicable to the trust relative to the transfers of L to M.

After the proposed transfer of all of the assets of L to M, M will be treated as possessing the aggregate tax benefit of L consistent with section 1.507-3(a)(1) and (2)(i) of the Regulations. Therefore, in determining whether M qualifies under section 4940(e) of the Code for the reduction in excise tax after such transfer is made, the experiences of both L and M (i.e., qualifying distributions and net investment income) during the previous five-year base period should be aggregated and treated as though L and M were one Foundation during such base period for purposes of making the calculation required by Part V of Form 990PF.

Because M is an organization recognized as exempt under section 501(c)(3) of the Code, M is not a disqualified person for purposes of section 4941 of the Code. Accordingly, the proposed transfer of assets by L to M will not constitute an act of self-dealing under section 4941 of the Code.

Because the transferor foundation, L, transfers all of its assets to the transferee foundation, M, for purposes of section 4942, M is treated as though it were L. Accordingly, the transfers to M are not treated as qualifying distributions of L.

The proposed transfer is a 507(b)(2) transfer of assets by L, a private foundation, to M, another private foundation, therefore, the proposed transfer is not a taxable expenditure. Since L proposes to transfer all of its assets to M, L will not be required to exercise expenditure responsibility pursuant to section 4945(d)(4) and (h) of the Code once the transfer has occurred. However, M represents that it will continue to exercise expenditure responsibility for other grants for which expenditure responsibility is required.

Accordingly, based on the foregoing we rule as follows:

1. The transfer of the assets of L to M will not affect the status of L as an organization described in section 501(c)(3) of the Code;
2. The transfer of the assets of L to M will constitute a transfer described in section 507(b)(2) of the Code and will not constitute a termination of L's private foundation status giving rise to imposition of the termination tax under section 507 of the Code;

3. The transfer of the assets of L to M will constitute a transfer described in section 507(b)(2) of the Code, and accordingly, M shall not be treated as a newly created organization;
4. After the transfer of the assets of L to M, the qualifying distributions and net investment income histories of both Foundations shall be aggregated for purposes of determining whether M qualifies under section 4940(e) of the Code for reduced excise tax on net investment income;
5. The transfer of assets by L to M will not constitute an act of self-dealing within the meaning of section 4941 of the Code with respect to M, any foundation manager, or other disqualified persons;
6. Because of L's transfer of all of its assets to M, the transferee foundation, M is treated as though it were the transferor L, for purposes of section 4942. See section 1.507-3(a)(9) of the Regulations.
7. The transferor foundation, L, is not required to exercise expenditure responsibility under section 4945 (h) with respect to the transfers.
8. The transferor foundation, L, is required to exercise expenditure responsibility over any outstanding grants until the time it disposes of all of its assets and must satisfy the section 4945(h) reporting requirements for the taxable year in which the transfers were made. Following the transfers and during any period in which L has no assets or activities, L is not required to exercise expenditure responsibility with respect to any of its outstanding grants.
9. Based on the representation that the legal and accounting expenses incurred to implement the transfer of L's assets to M are reasonable and necessary expenses paid to accomplish a purpose described in section 170(c)(1) or section 170(c)(2)(B) of the Code, and that therefore, (a) pursuant to section 53.4942(a)-(3)(a)(2)(i) of the Regulations, such legal and accounting expenses will constitute "qualifying distributions" under section 4942 of the Code, and (b) if paid in the good faith belief that they are reasonable and consistent with ordinary business care and prudence, the expenses will not themselves be taxable expenditures, pursuant to section 53.4945-6(b)(2) of the Regulations.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

We have sent a copy of this ruling to your representative as indicated in your power of attorney.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Manager, Exempt Organizations  
Technical Group 3

Enclosure  
Notice 437

cc: